

Draft Fund Regulations

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In line with international best practices, the UAE Central Bank ("Central Bank") and the Emirates Securities and Commodities Authority (the "ESCA"), the financial regulators in the UAE are getting stricter and have issued several regulations in the recent past to license and regulate activities which were commonly being conducted by entities from off shore without attracting any licensing requirements.

ESCA issued draft regulations in January 2011 to regulate investment funds in local and foreign securities ("Regulations") and to take over the responsibility of regulating domestic and foreign funds from the Central Bank. It is our understanding that these Regulations are currently being amended and are likely to be finalized and issued before the end of 2011.

We broadly highlight various aspects of the new proposed regulations including the scope of funds that are regulated, the informal adoption of certain procedures by ESCA, the additional requirements for foreign funds.

There is ambiguity as to whether the scope of the Regulations is restricted to only cover funds set up for the purpose of investing in listed securities or whether the intention is to cover a wider group of investment funds (i.e. private equity, hedge funds, property funds, fund of funds etc). While there are some provisions where the scope appears to be wider but most provisions can only be applicable to funds investing in listed securities. An example is the requirement of daily valuations of investments of a closed-ended fund, which is impracticable. A closed-ended fund such as a property fund is usually only required to value property every six months or annually or in some instances upon acquisition or disposition. Therefore, it is unclear whether the new amendments will reflect any changes in the general scope of the types of funds to be further regulated or will retain the current ambiguity.

Even though the final Regulations have not officially been issued, several provisions are being applied by ESCA on an informal basis. ESCA has issued a form of application which is to be completed and submitted to them prior to any entity commencing the marketing of any foreign investment fund in the UAE. ESCA is applying the provisions of Part V (Promotion of foreign fund units within the State) of the Regulations in relation to any such application and ESCA must approve any such marketing proposal prior to any marketing activity taking place.

Approval to market foreign investment funds in the UAE will only be issued by ESCA to entities holding an appropriate Central Bank license permitting it to undertake that activity. These entities are commercial banks and investment companies. Additionally the foreign fund must be licensed and regulated under a foreign regulatory authority equivalent to ESCA and the sponsor and the service provider of the foreign fund must be licensed and also regulated under a foreign regulatory authority equivalent to that of ESCA. These new conditions provide more regulation comparable with other jurisdictions; for e.g. exempt funds do not require approval or licensing from foreign regulatory authorities. It remains to be seen how ESCA will deal with these issues.

The Regulations do not make a distinction between private funds to be marketed on a private placement basis to a small number of sophisticated high net worth investors and public funds intended to be marketed to a larger group and to retail customers. It would be usual for requirements for these two types of funds to be substantially different given the different target investor. Typically, sophisticated high net worth investors are savvy enough to not require stringent regulations that are typically imposed on funds being offered to the general public. However, the Regulations do not recognize this differentiation.

It isn't clear what the form of a fund will be. If it is a separate legal entity, will the shares be owned by the

unit holders or investors or will they be owned by the investment manager. How will the nationality of the fund be determined (i.e. will it have UAE nationality for the purposes of investment or will it have the nationality of the investors in the fund)? This is a very important issue given the foreign ownership restrictions relating to certain asset classes (i.e. land, shares etc).

The distinction between the roles of investment manager, administrative services company and safe custodian are not well defined.

In conclusion, the Regulations have been long overdue and its release and implementation is widely anticipated.

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